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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

In the Matter of	)	
	)	
Federal-State Joint Board on	)	CC Docket No. 96-45
Universal Service	)	

REPLY COMMENTS OF THE WESTERN ALLIANCE

As the representative of companies serving ratepayers in some of the most remote, high-cost service areas in the United States and its island territories, the Western Alliance is struck by the irrelevance of most comments in this proceeding to the real-world circumstances of its membership. Notably, a large number of commenters support proxy mechanisms as the basis for universal service support, but give scant notice to the admitted, undisputed failure of those models to reflect the costs of the small carriers whose need for universal service support is greatest. Similarly, some commenters urge that the system should not support the recovery of embedded costs, but disregard the fact that small companies have made embedded investments primarily to satisfy regulatory mandates over which they have no control. The record made by these comments will support, at most, the use of proxies as a means of calculating support for large, price-cap companies, and the denial of support for the recovery of embedded investment made strictly in the exercise of ordinary business judgment. The imposition of proxies on small, high-cost carriers, and the confiscation of investment those carriers have made to satisfy their obligations as carriers of last resort, cannot be supported by the record, will violate section 254 of the Telecommunications Act of 1996[1] and will raise substantial constitutional concerns.

I. The Comments Show That Proxies Will Not Meet The Objectives Of The 1996 Act In Rural And High-Cost Areas Served By Small Companies.

Although many commenters urge the Commission to adopt a proxy model as the basis for calculating the total service long-run incremental cost of providing basic service to rural and high-cost customers, even proponents of those methods concede that proxies will systematically misrepresent the per-line cost of the subscriber plant of small, rural carriers.[2] As a number of comments also demonstrate, the resulting under-allocation of support to many rural companies will be entirely unrelated to the efficiency or inefficiency of those companies; instead, it will result from the flawed assumptions contained in the model and the absence, in smaller companies, of a large base of diverse service areas that might permit under-allocations to some areas to be offset by over-allocations to others.[3]

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[1] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, sec. 254 (1996)(hereinafter the "1996 Act" or the "Act").

[2] *See, e.g.,* Comments of NYNEX at 10, discussing the Benchmark Cost Model ("BCM") proposed by MCI, NYNEX, Sprint and US West. ("The BCM should only be used to calculate support amounts for price cap (*i.e.* large) LECs [because] such a model may not accurately portray the costs of a carrier that serves only a limited or smaller area, and thus could cause financial harm to small carriers.") *See also* MCI Comments at 11; Comments of US West, Inc. at 9; Comments of US West Communications, Inc. in CC Docket 80-286 at 26. The other, principal proxy cost model -- the one proposed by Pacific Telesis -- is proprietary and therefore cannot be adequately assessed at all. *See, e.g.,* Comments of Teleport Communications Group, Inc. at 8.

[3] *See, e.g.,* Comments of the Rural Utilities Service at 6 and 15; Comments of Southwestern Bell Telephone Company at 14-16; Comments of NYNEX, *supra* at 10. In fact, the exhaustive study described in Southwestern Bell's comments shows that the Benchmark Cost Model does not work for any LECs, large or small, rural or urban, but rather produces results that are comprehensively inaccurate. Comments of Southwestern Bell Telephone Company, *supra* at 14-16. While large, price-cap companies may average the effects of these systematic inaccuracies over a wide range of service environments, small companies have no such opportunity.

Since *no commenter in this proceeding* has shown that the proposed proxy models will yield accurate numbers for the reasonable cost of service of small, rural carriers, the question of the application of the proposed proxy models to rural companies must be regarded as settled.[4] The record does not support the use of proxies for small companies; in fact, the record makes it clear that adoption of an across-the-board proxy approach will violate the Commission's mandate, under section 254 of the Act, to implement a universal service system that is both predictable and sufficient to achieve the Act's goal of reasonable parity between the quality and cost of urban and rural service.[5] Any universal service rules applied to smaller companies, therefore, should calculate universal service supports according to actual, company-specific costs.

II. The Universal Service System Must Permit Carriers To Recover Their Embedded Costs.

Some commenters argue that local carriers should not be allowed to recover embedded costs because those costs represent nothing more than "overbuilding by the LEC in support of its competitive strategies, or simply the misforecasting of its plant requirements."[6] Notably, one commenter contends that local carriers should have foreseen the onset of local competition long ago, and should have scaled back their investment in local plant accordingly.[7] This commenter assures us that regulators would

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[4] At most, some proponents of proxies suggest that more refined models, so far undeveloped, might bring the range of error within acceptable limits. *See, e.g.*, MCI Comments at 11; Comments of Teleport Communications Group, Inc. at 7-8. But until someone proposes, and convincingly demonstrates the accuracy of, such an improved proxy model, the universal service requirements of section 254 of the 1996 Act do not permit the use of proxies to calculate supports for smaller companies.

[5] 1996 Act, *supra* at §254(b)(3), 254(b)(5).

[6] Comments of Ad Hoc Telecommunications Users Committee ("Ad Hoc Comments") at 10; *see also* Comments of MFS Communications Company, Inc. at 18-19.

[7] Ad Hoc Comments, *supra* at 10.

not object to this abandonment of the commitment to universal service; and that, in fact, "[r]egulators can and should reasonably expect LECs" to reduce their network investment in anticipation of the eventual "onset of competition."[8]

In the real world, of course, local telephone companies are carriers of last resort. They are required to make whatever level of investment will ensure that their networks reach, and provide a high level of service to, every business and residence in their service area that wants a telephone. The commitment of these companies to universal service is not one management option among others: it is a regulatory mandate over which those companies have no control. It ignores reality to suggest that these carriers could have avoided the problem of stranded investment simply by announcing to their regulatory commissions, years ago, that they no longer would honor this mandate.

No one suggests that the universal service system should compensate carriers in a competitive environment for imprudent investments that were voluntarily made. It is well-recognized, however, that regulators may not mandate investment, then take subsequent actions that render that investment worthless.[9] Regardless of the type of universal service system the Commission adopts, therefore, that system should take into account the prudent investment carriers have made to meet their obligations as carriers of last resort, and should permit that investment to be recovered.

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[8] *Id.*

[9] *See* Comments of the Western Alliance at 10-12 and authorities cited therein.

Conclusion

The Telecommunications Act of 1996 directs the Commission to work toward a specific goal -- *i.e.*, reasonable parity in the quality and cost of the telecommunications services available to urban and rural customers -- and to fashion rules that are both predicable and sufficient to achieve that goal. The record in this proceeding offers no evidence that proxy models or other surrogates for actual costs will achieve the goal set by Congress, or even maintain the level of urban-rural parity already achieved. Accordingly, those approaches should not be adopted, or should be implemented only provisionally for the large, price-cap carriers to which those approaches are more appropriate. For small, rural carriers, changes in universal service should come through refinement of the existing, actual-cost approach, rather than abandonment of that approach in favor of surrogates that are admitted -- even by their proponents -- to pose a risk of substantial harm for rural ratepayers.

Respectfully submitted,

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